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FINANCING OF COTTON

BY JOHN J. ARNOLD,

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The Farmer.—The conditions of the farmers or producers of cotton vary considerably in the several cotton states. In some localities the farms are small, consisting of from five to ten acres and upwards, while in other localities large cotton plantations consisting of from five thousand to twenty-five thousand acres each are owned and controlled by corporations or syndicates. Nevertheless the financing of the farmer, that is the worker of the soil, is done in very much the same way. In localities where the smaller farms prevail many of the owners or lessees, as the case may be, are people of comparatively small means, and it is necessary in many cases that they be furnished financial aid to tide them over the period from seed time or even before to the time of the selling of the crop. This is done through the local merchants, who make advances by means of furnishing the farmers with the necessities of life to the extent of from thirty to forty per cent of the estimated value of the cotton which the farmers are likely to produce. The merchants in turn find it necessary to borrow from their bankers, and naturally charge their customers a rate of interest higher than that which they are called upon to pay, the transaction therefore netting them a profit to which they are entitled considering the risk which they assume.

The raw cotton when picked and before ginning is brought to the local merchants who have made the advances, who weigh the same and give credit on their books at the market value. At the end of the season when the farmers have delivered all of their cotton the accounts are squared and the farmers paid in actual cash the amounts due them. In the event that a farmer is in a financial condition so that he does not require the assistance of the merchant he usually takes his cotton direct to the gin and has the same ginned and baled, paying the gin for the operation, selling his cotton to a local cotton merchant and the seed to an oil mill, or leaves his cotton in storage to be sold by the merchant for farmers' account. In either event the gin issues what is known as a gin receipt, against the pro-

duction of which the cotton will eventually be delivered. In the case of the cotton plantations owned by corporations or syndicates the same procedure takes place. The plantation is sub-divided into small sections which are leased to farmers, either on the basis of a fixed charge per acre or on the basis of a percentage of the actual production. In place of the local merchants, however, general merchandise stores owned by the plantations supply the farmers in a like manner as do the merchants in the localities of the smaller farms. In such communities the gins and oil mills are owned and operated by separate corporations or individual owners as the case may be, while each plantation usually has its own gin and mill. During the active season of the year the corporations owning the plantations also are liberal borrowers from their bankers.

The above covers the financing of the cotton crop to and from the soil to the gin and oil mills.

From Gin to Compress.—After the seed has been removed at the gin the cotton is baled in packages of 28 x 56 x 42 inches in size, weighing approximately five hundred pounds, including twenty pounds bagging and steel straps, thus having a density of about fourteen pounds per cubic foot. In this condition the cotton is bought by cotton buyers for export or for delivery to American mills, the seller delivering the same to a railroad or compress point, where the cotton is sorted according to grade, compressed and marked, the size being reduced to 28 x 56 x 18 inches, giving a density of from twenty-eight to thirty pounds per cubic foot.

Shipping on Consignment.—In many instances the cotton is merely sent on consignment to cotton factors, who put the same in storage, making an advance of possibly sixty to seventy-five per cent of the market value, and when the cotton is finally sold the cotton factors are reimbursed for the amount advanced plus interest, insurance and storage charges, and the balance is remitted to the shipper.

Financing the Cotton Factors.—While the cotton factors are usually of strong financial standing they necessarily must be heavy borrowers during the cotton season on account of the large advances made by them on cotton stored in their warehouses, and although they do not own the cotton outright, their bankers as a rule do not hesitate to make loans, taking the stored cotton as security.

Financing the Cotton Buyer

When cotton is bought the same is paid for in cash, which is usually accomplished in the following manner:

Cotton Bought at Gin.—The cotton buyers make arrangements with the local bankers where the gins are located, for the payment of the cotton, the banks furnishing actual cash against tickets issued by the buyer's representatives, holding the tickets in question as their collateral in the meantime. When a sufficient amount of cotton has been accumulated the local banker at the request of the buyer's agent delivers the tickets in question to the local agent of the railroad, who in turn issues a bill of lading covering the shipment to compress point, which then is attached to the draft drawn by the buyer's agent upon the buyer's head office, which draft includes the price paid for the cotton plus interest and exchange charged by the local banker, who is reimbursed by the amount of the draft thus drawn. When this cotton is ready for export local bills of lading covering shipment from point of origin to compress point are exchanged by the cotton buyer's banker for local bills of lading to port or for through bills of lading.

Cotton Bought at Compress.—When cotton is bought at compress points, compress receipts instead of tickets are delivered to the local banker, who pays for the cotton as purchased by the buyer's representatives from time to time. When a sufficient amount of cotton is ready for shipment the compress receipts are exchanged by the banker for local bills of lading to port or through bills of lading as the case may be. These bills of lading are attached to the draft drawn by the representatives on the head office of the buyer, the local banker being reimbursed for the amount thus drawn.

Concentrating Cotton.—Owing to the fact, however, that cotton to go abroad in one shipment is usually bought by representatives of the buyers in different sections of the country, much of the cotton itself is frequently allowed to lie at concentrating points until a sufficient amount of the particular grade desired has been secured. It therefore becomes necessary for the cotton buyer to borrow heavily from his local banker with whom he has arranged for a line of credit, which is given to him in the form of an overdraft or against demand notes, against which the banker holds the bills of lading which have come forward attached to the drafts drawn by the buyer's representative. To illustrate: A cotton buyer

in Dallas, Texas, has representatives who are buying cotton at Bowie, Weatherford, Cisco and McKinney, Texas, this cotton to go abroad in one shipment. Let us say that the cotton is shipped from the various compress points to port on local bills of lading which come forward to the Dallas banker attached to the drafts drawn on the Dallas buyer. Naturally, cotton being shipped from various points would reach port at different times, but none of it can be realized upon until the entire shipment is completed, thus necessitating the tying up of considerable funds which have been advanced by the Dallas banker. When sufficient cotton has been received, the local bills of lading held by the Dallas banker are forwarded to his banking correspondent at the port and there exchanged for port or ocean bills of lading, which are issued by the steamship companies upon the actual delivery of the cotton. Such port or ocean ladings are then forwarded to the Dallas banker. The Dallas buyer, who now becomes the seller or exporter of the cotton, draws his draft on the reimbursement furnished by the European buyer in the currency of the country in which the reimbursing bank is located, and the draft having been sold to a foreign exchange banker, say in Chicago or New York, is delivered to the Dallas banker, together with a draft on the Chicago or New York buyer of the exchange, in United States currency, to which then are attached the port or ocean bills of lading, insurance certificate, etc., thus reimbursing the Dallas banker by the amount of the draft so delivered.

Concentrating Bills of Lading.—Or it may be that instead of securing local bills of lading from the compress points to port, through bills of lading have been secured, in which event the bills of lading in question are concentrated at Dallas while the cotton goes direct to port for shipment abroad. In this case the Dallas cotton buyer draws his draft on the European reimbursement in a like manner as above, but instead of port bills of lading, through bills of lading are attached, which latter cover the shipment via a stated railroad and steamship company. In the event that ginned cotton is delivered at a compress point which is also a concentrating point, the local bills of lading attached to the drafts drawn by the buyer's representative are delivered by the buyer's banker to the compress, and the banker receives in lieu thereof compress receipts which he holds as collateral against the buyer's obligation caused by the bank having honored the draft drawn against the shipment to the buyer's

debit. When the cotton in question is ready for shipment, the bankers have the compress receipts exchanged for port or ocean bills of lading, the further financing being done in like manner as when cotton is shipped from outside compress points direct to port.

Cotton Sold to American Mills.—In the event of a shipment of cotton going forward to American spinners, practically the same method of financing is employed with the exception that the cotton buyer, who now becomes the seller, draws his draft direct on the mill in United States dollars instead of on the European reimbursement in foreign currency, eliminating, of course, the foreign exchange buyer entirely.

Financing Exports

Covering the drawings against cotton exports, three principal methods of reimbursement are employed: Bankers' unconfirmed credits, consignees' acceptances (documents delivered against payment) and spinners' acceptances (documents delivered against acceptance).

Bankers' Credits.—By far the largest percentage of cotton is exported under bankers' unconfirmed credits. At the beginning of the cotton season the European buyer usually makes arrangements with his bank or banks for a line of credit up to the limit of which the banks in question agree to accept drafts drawn by the American exporters against cotton shipped for account of the European buyer in question. Such drafts are usually drawn at 60d/s, 90d/s and in some cases 180d/s. When the European buyer of the cotton makes a contract with an American exporter covering a given number of bales of a specified grade, he at the same time notifies the American exporter of the name of the bank upon whom the draft is to be drawn. Such drawings are always purchased by the American foreign exchange buyer with the understanding that the documents are to be delivered to the drawee bank against its acceptance. After such delivery of documents the American foreign exchange buyer does not look to the cotton as collateral, but holds the accepting bank and the drawer of the bill responsible. The European bank, of course, holds the shipping documents under which it has absolute control of the cotton. In most cases, however, the same are delivered to the European buyer upon arrival of the ship and the cotton

is frequently delivered to the spinners to whom the same has been sold by the European importer or buyer and paid for before maturity of the acceptance under which the same came forward. The European buyer, of course, is called upon to pay the European bank a commission for the credit in question. Under this method of bankers' unconfirmed credits, the entire transaction, in so far as the European buyer of the cotton and his bank are concerned, is based wholly upon credit, no funds whatsoever being advanced by either of them. The American foreign exchange buyer, who has advanced actual cash, or its equivalent, however, does not find it necessary to tie up his funds for any length of time unless he desires to do so. European discount houses and banks, other than the one upon which the particular draft in question is drawn, usually are eager bidders for the discounting of such bills, and the American foreign exchange buyer receives by cable daily quotations at which bills going forward within a specified time can be discounted. Let us say, for instance, that a foreign exchange buyer in Chicago, on the morning of a business day, makes a bid for a draft drawn at 60d/s upon a London bank covering a shipment of cotton amounting to say £10,000 sterling. The following points must be considered.

The rate of exchange at which a demand draft on London can be sold:

- English stamp charges.
- Cost of collection.
- Rate of discount abroad.
- Margin of profit.

To illustrate:

Rate per £ sterling at which a demand draft on London can be sold.	4.8500
English stamp charges024
Cost of collection010
Discount for 63 days at 2½ per cent242
Margin of profit024
	— .0300
	<hr/> 4.8200

The rate, therefore, which a Chicago foreign exchange buyer could pay for a 60d/s draft would be \$4.82 per £ sterling.

Payment Bills.—Under the second method, viz., that of documents delivered against payment of the drafts in question, the drafts

are drawn by the southern cotton buyer or exporter upon a European buyer or importer instead of upon a bank. In this case the American foreign exchange buyer forwards the documents together with the draft to his European correspondent with instructions that the draft be presented for acceptance, but that documents be delivered only upon the actual payment of the draft. The cotton, upon arrival abroad, is stored for account of the American foreign exchange banker and the drawee or acceptor is at liberty, at any time, to call upon the European bank, in whose possession the documents are, and tender payment for the draft, less the rebate, for the number of days the draft has still to run before maturity.

Rebating Payment Bills.—The rate of rebate is dependent on the bank rate prevailing at the time when such draft is paid. In England the rebate rate is one per cent below the Bank of England rate, while on the continent the actual bank rate is figured. Inasmuch as the taking up of such bills is subject to the call of the drawees, European bankers rarely are willing to discount the same. It must be further noted that with a bill of this character, only the names of the drawers and drawees are back of the documents, and on this account the American foreign exchange banker must necessarily limit his purchases of this character of bills to the amount of credit which he is willing to furnish the drawers and acceptors, holding the cotton as collateral.

Making Payment Bills Liquid.—The amount thus invested can be made liquid by the American foreign exchange banker drawing his time draft upon his European correspondent, who accepts the draft and holds the documents controlling the cotton which came forward attached to the payment bills as collateral. The time draft thus drawn can be discounted by the drawer in the foreign discount market and the proceeds availed of by the sale of his demand check, or he can sell the time draft in the open market in America. If payment bills are thus made liquid the amounts paid by the acceptor before maturity of the drafts are allowed to accumulate to the credit of the American banker's account abroad to eventually pay his own draft at maturity. In this case he will be called upon to pay a commission to the European bank for accepting the time drafts, which necessarily must be taken into consideration in the price paid for the payment bills. On this account payment bills do not net as much to the American exporter as do drafts under bankers' credits,

but on the other hand, the European buyer saves the commission which he would have to pay his bank for furnishing the acceptance. The American buyer of the exchange when bidding on a 60d/s payment bill to be financed by issuing his own sixty-day draft on London instead of being able to pay the rate of \$4.82, which he could allow for a banker's 60d/s draft, would deduct the cost of the acceptance of his draft—let us say one-eighth of one per cent. His figures would then be as follows:

The rate for a demand draft on London.....	4.8500
English stamp charges024
Cost of collection010
Discount for 63 days at $2\frac{7}{8}$ per cent242
Margin of profit024
Charges for acceptance062 $\frac{1}{2}$
	<hr/>
	.03625
	<hr/>
	4.81 $\frac{3}{8}$

The question of the rate of interest allowed on balance accumulating in the foreign bank, as compared with the rebate rate, must also be taken into consideration.

Spinners' Acceptances.—Under the third method, viz., where drafts are drawn on spinners direct, documents to be delivered against acceptance, the acceptances run to maturity and it is possible to have the same discounted in the open discount market, but usually the rate of discount for such bills is higher than is that for bankers' bills. The buyer of such drafts, therefore, in making his bid must, of course, figure in the rate at which such bills can actually be discounted, the difference ranging from one-eighth to one-fourth of one per cent per annum above bankers' rates, depending upon the money market.

Bills Bought for Investment.—When conditions are favorable the foreign exchange banker instead of discounting all of the bankers' and spinners' acceptances or issuing his own time drafts against payment bills will buy such drawings and hold the same as an investment to be collected and disposed of at maturity. It usually occurs that during a heavy export movement exchange rates are low and on account of the large demands made upon the discount houses abroad, discount rates are high. When this condition pre-

vails, time bills can be bought on a low basis while the exchange at the maturity of the bills probably will have advanced, thus showing a comfortable earning on the investment.

Method of Bidding.—The bids above referred to are made by wire to a foreign exchange broker in the South, and before the close of the day's business, telegraphic advices will have been received as to the amount of exchange which the bids had been successful in securing, as a result of which the foreign exchange buyer cables his European correspondent accepting discount for the amount involved.

Currency Movement.—When the draft drawn by the Southern cotton buyer or exporter upon the European reimbursement comes forward to the Chicago foreign exchange buyer, the amount drawn for in United States dollars is placed to the credit of the Southern bank by which the same was negotiated. In this way the Southern banks during the cotton season accumulate large balances in the Northern and Eastern centers which they are unable to dispose of, as a consequence of which the actual cash is shipped to the South from time to time, to cover the cost of which the Southern bankers naturally charge their customers what is known as exchange. If the foreign exchange banker in the centers outside of New York does not have sufficient local demand for his foreign exchange, the balances accumulated abroad are disposed of by the sale of demand checks or cable transfers to New York foreign exchange houses. It is, therefore, evident that in the bidding for drafts drawn against cotton shipments the rate at which New York exchange can be disposed of must be taken into consideration. If, for instance, New York exchange is ruling at twenty-five cents a thousand dollars discount, the Chicago banker could pay on the basis above referred to a rate of \$4.82 per pound sterling, less the twenty-five cents per thousand which it would cost to get rid of his New York exchange, equaling approximately twelve cents per £100 sterling. He would, therefore, be able to pay only \$4.81½. Should, however, New York exchange rule at a premium in Chicago, then the opposite would result.

Gold Importations.—If the New York banks do not find sufficient demand for foreign exchange to dispose of their balances abroad settlement must be made in actual gold, resulting, of course, in gold importations.

Purchases Limited.—At the beginning of the season the American buyer, after having thoroughly acquainted himself with the financial and moral standing of the exporters from whom he buys exchange, arranges the lines up to the limit of which he is willing to accept drawings of the various kinds of bills. He also decides upon the line of acceptances of any of the European banks he is willing to negotiate. When the limit is reached, the brokers are notified and the seller of exchange in the meantime must place the same elsewhere.

Hypothecation of Cotton.—The foreign exchange banker also secures from the exporter what is known as a general hypothecation, under which the latter authorizes him, in the event of the dishonor of any draft, to take possession of the cotton and dispose of the same in the market, applying the proceeds against the drawer's obligation, collecting the balance from, or remitting the surplus to, the drawer in question. In addition to this, the banker is authorized, unless otherwise and specially instructed, to deliver the documents against the acceptance of the drafts.

Insurance of Cotton

Inasmuch as cotton is of a perishable and inflammable character, the same is covered by insurance from the time that it is delivered to the gin, when it comes under what is known as a ginner's local fire policy, and the bankers advancing the funds each, in turn, insist upon being fully protected against loss either by fire or the sinking of a vessel, which may be covered by a separate policy on each shipment, in which event such policies are attached to the drafts, or under an open policy, in which event satisfactory evidence from the insurance companies to the effect that such a policy has been issued is placed on file with the bankers concerned.

Hedging

The cotton buyers in the South are in daily communication by cable with their European connections. Let us say that a cotton buyer in Dallas in the morning receives an order from abroad to purchase five thousand bales at a stated price covering a specified grade of cotton. He immediately wires orders to his representatives, and inasmuch as he usually has quite a number of such

representatives in various sections of the country, it frequently happens that at the close of the day's business when all of the purchases have been reported, it is learned that more than the order in question has been bought, and not wishing to speculate, the Dallas buyer immediately goes to the cotton exchange and there disposes of the number of bales overbought, but instead of selling spot cotton, he sells futures. Should the market on the following day for spot cotton have reacted, the bales overbought the day before would have to be sold at a loss, but inasmuch as the spot market moves in sympathy with the future market, the buyer of the cotton would be in a position to buy against the futures which he has sold, at a profit equal to the amount lost on the spot transaction. This is what is known as legitimate hedging of cotton in order to prevent speculation. Should the cotton buyer at the close of the day's business learn that the amount of cotton purchased was not sufficient to cover the amount sold abroad, then he would become a buyer of futures instead of a seller.